Many Are Sounding the Alarm on a Huge Canadian Housing Bubble

Description

If the Bank of Canada monitors surging home prices constantly, it could mean the housing market is in a bubble right now. Deputy Governor Lawrence Schembri said, “We’ve taken note of the fact that house prices have increased relatively rapidly in recent months.” He adds that what happened in 2020 was very unusual.

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The stringent and widespread restrictions shut down the housing market. However, there was a release of pent-up demand following its reopening. David Rosenberg, Rosenberg Research’s Chief Economist and Strategist, told BNN Bloomberg, “This might be one of the biggest bubbles of all time. It’s been predicated on where mortgage rates are.”

Alarm bells ringing

Rosenberg isn’t the only person who is very vocal about a huge looming bubble of historic proportions. Even economists from Canada’s big banks are issuing warnings. Derek Holt, **Scotiabank’s** Head of Capital Markets Economics, said, “Ottawa has been caught completely off-guard in the magnitude of the housing response to very low financing costs,”

BMO Economist Robert Kavcic’s report to clients read, “Recall that 2016-2017 was characterized by mini-bubbles in and around Toronto and Vancouver that elicited macroprudential policy responses at both the federal and provincial levels. He believes we’ve reached the same situation today.

Bankers and economists find the increasingly astonishing price growth in some of Canada’s housing markets alarming. Meanwhile, the Bank of Canada will maintain its benchmark overnight interest rate at 0.25%. The policymakers describe the recent housing market activity as being “much stronger than expected.”

Acceptable trade-off

For Stephen Poloz, former Bank of Canada Governor, the domestic housing market’s heat is an acceptable trade-off to stave off a bad recession. The interest rate cut should boost the economy. He'll take the cut every day if the side effect is a hot housing market. Current Bank of Canada Governor Tiff Macklem intends to keep the policy rate at that effective lower bound until 2023.

Alternative to direct ownership

Investing in real estate over the long-term is a good idea, especially for rental properties, because it can produce reliable income streams. When the value appreciates, you can liquidate the hard asset. In the current environment, you have two options, hands-on and hands-off. The first is purchasing physical property, while the second is real estate investment trusts (REITs).

Besides a substantial cash outlay, you must have extensive experience and actively manage the property in direct ownership. REIT is the alternative if you want to do away with the three requirements. You play a landlord's role and receive dividends, much like receiving rental income.

The **True North Commercial** (TSX:TNT.UN), a $583.69 million REIT, is a cash cow. You can purchase this real estate stock at $6.77 per share and partake of its juicy 8.75% dividend. A $100,000 investment will produce $8,750 in annual passive income.

True North owns 48 commercial properties only, but its tenant base makes is its strongest advantage. Canada's federal government is the anchor tenant in 13 properties, while provincial governments are lessees in five properties. The tenant retention and occupancy rates are perennially high.

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A small price to pay

Mortgage rates may increase in due course as bond yields rise. However, Poloz believes that keeping interest rates at historically low levels is a small price to pay versus a deep recession.

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